INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	1
Statutes involved	2
Statement	3
Argument	8
Conclusion	16

CITATIONS

Cases:

Bassick v. *Commissioner*, 85 F. 2d 8, certiorari denied, 299 U. S. 592, rehearing denied, 299 U. S. 623	15
Commissioner v. *Court Holding Co.*, 324 U. S. 331	13
Hazeltine Corp. v. *Commissioner*, 89 F. 2d 513	14
Halliburton v. *Commissioner*, 78 F. 2d 265	14
Heberlein Patent Corp. v. *United States*, 105 F. 2d 965	14
United States v. *Cumberland Pub. Serv. Co.*, 338 U. S. 451	13
United States v. *Rodgers*, 94 F. 2d 666	15

Statutes:

Internal Revenue Code, Sec. 113 (26 U. S. C. 1946 ed., Sec. 113)	2
Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 112	3, 9

877280—50——1

In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 589

AMERICAN BANTAM CAR COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 116a–137a) are reported at 11 T. C. 397. The opinion of the Court of Appeals (R. 143) is reported at 177 F. 2d 513.

JURISDICTION

The judgment of the Court of Appeals was entered November 14, 1949. (R. 144.) The petition for certiorari was filed February 10, 1950. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the exchange under which the taxpayer's assets were acquired was one in which neither gain nor loss was to be recognized under

Section 112 (b) (5) of the Revenue Act of 1936 so that the basis of the assets was their basis in the hands of the transferors pursuant to Section 113 (a) (8) (A) of the Internal Revenue Code.

STATUTES INVOLVED

Internal Revenue Code:

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(8) *Property acquired by issuance of stock or as paid-in surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

* * * * *

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(26 U. S. C. 1946 ed., Sec. 113.)

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(b) *Exchanges Solely in Kind.*—

* * * * *

(5) *Transfer to corporation controlled by transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

* * * * *

STATEMENT

The facts as stipulated (R. 16a–87a) and as found by the Tax Court (R. 118a–123a) may be summarized as follows:

On August 21, 1935, the liquidating trustee of the American Austin Car Company sold the assets of Austin to R. S. Evans, Martin Tow, and W. A. Ward, Jr. (hereinafter collectively called the "associates"), for the price of $5,000 cash. The assets were bought subject to certain liabilities of Austin in the amount of $219,099.83. (R. 118a.) A general plan of organizing the taxpayer to take over the Austin assets from the associates was conceived in May, 1936. The plan contemplated the organization of a Pennsylvania corporation to be known as the American Bantam Car Company. The salient points of the contemplated plan included the following: The associates were to receive in exchange for their transfer of Austin assets to taxpayer 300,000 shares of no par common stock, which would comprise all of the taxpayer's stock upon its issuance to the associates; transfer to taxpayer of such assets would be subject to liabilities totaling $219,099.83; 90,000 shares of taxpayer's preference stock would be offered to the public at $10 a share; the underwriters of such issue of preferred stock were to receive from the associates, in addition to their underwriting discounts and commissions, and as further compensation for their services as underwriters, certain amounts of the common stock issued to the associates as and if they effected sale to the public of certain amounts of the preference stock. All the interested parties orally agreed to the substance of this plan prior to June 2, 1936,

though there was no formal written contract between the parties at this time. (R. 118a–119a.)

On June 2, 1936, taxpayer was incorporated under the laws of the Commonwealth of Pennsylvania with an authorized capital stock of 700,000 shares, consisting of 100,000 shares of preference stock of the par value of $10 per share, and 600,000 shares of common stock without par value. (R. 119a.)

Taxpayer's articles of incorporation provided (R. 119a–120a):

> At all meetings of stockholders the holders of preferred stock shall be entitled to 3 votes for each share of preferred stock held by them, and the holders of common stock shall be entitled to 1 vote for each share of common stock held by them.

On June 3, 1936, the associates transferred to taxpayer the Austin assets subject to liabilities which at the time amounted to $219,099.83, together with the sum of $500 in cash and, simultaneously therewith, taxpayer issued to the associates 300,000 shares of its common stock in proportion to their respective interests in these properties. (R. 120a.)

On June 8, 1936, taxpayer executed a written contract with Dingwall & Company, Inc., a New York corporation, and Tooker & Company, a partnership, providing for an irrevocable and exclusive selling order on 90,000 shares of taxpayer's convertible preference stock for a period of six

months from the effective date granted by the Securities Exchange Commission at a public offering price of $10 per share less commissions of 15 per cent and allowance expenses of 5 percent. The following selling schedule was provided: 20,000 shares during the first two months after the effective date granted by the Securities Exchange Commission, 15,000 shares during the third month after such date, 17,500 shares during the fourth month after such date, 17,500 shares during the fifth month after such date, and 20,000 shares during the sixth month after such date. If Dingwall & Company, Inc., and Tooker & Company failed to execute the selling order in accordance with this schedule, taxpayer was given the option to cancel the selling order on ten days' notice. (R. 120a–121a.)

On June 8, 1936, concurrently with the above contract, the associates entered into a written contract with (a) Dingwall, (b) James Botz, who was a partner in Tooker & Company, and (c) Edgar S. Grant, a wholesaler for Dingwall. In substance the associates agreed to deliver to the Butler County National Bank & Trust Company of Butler, Pennsylvania, certificates for 100,000 shares of common stock endorsed in blank for transfer to the underwriters. The underwriters were to be entitled to receive the stock in the amounts and at the times stated as follows: 22,500 shares of common stock when 20,000 shares of convertible preference stock had been sold, 16,500

shares of common stock when the next 15,000 shares of such convertible preference stock had been sold, 19,500 shares of common stock when the next 17,500 shares of such convertible preference stock had been sold, 19,500 shares of common stock when the next 17,500 shares of such convertible preference stock had been sold, and 22,000 shares of common stock when the next 20,000 shares of such convertible preference stock had been sold. (R. 121a.)

It was provided that in the event the selling order contained in the agreement between the taxpayer and Dingwall & Company, Inc., and Tooker & Company was cancelled pursuant to the cancellation provisions mentioned, then this agreement should likewise be cancelled with respect to the shares of common stock to which the underwriters had not become entitled at the end of the notice of cancellation. (R. 121a–122a.)

During the year 1936 only 14,757 shares of the preferred stock was sold by the underwriters. Finally, Grant & Company succeeded Dingwall & Company, Inc., and Tooker & Company as underwriters. Between October, 1936, and October, 1937, Grant sold 83,618 shares of convertible preferred stock to the public for $866,410 (there were no sales of convertible preferred stock between June 2, 1936, and October, 1936). There was no sale of common stock from June 3, 1936, to October 1, 1937. By October 31, 1937, Grant

877280—50——2

had sold 1,008 shares of common stock to the public. (R. 122a.)

During October, 1937, the associates, pursuant to their agreement with the underwriters of June 8, 1936, transferred to Grant 87,900 shares of taxpayer's common stock out of the 300,000 shares previously issued to them. (R. 123a.)

Taxpayer's stocks were held on October 31, 1937, in the following manner (R. 123a):

	Associates	Public	Grant
Common stock	212,100	1,008	86,892
Preferred stock		83,618	

In all of the income tax returns filed by the taxpayer for its taxable years through June 30, 1941, its basis for the assets acquired from the associates on June 3, 1936, was stated to be $145,075.66. For the taxable years ending, respectively, June 30, 1942, and June 30, 1943, in which taxpayer showed profit from war production, taxpayer stated the basis of Austin assets to be $840,800. (R. 123a.)

The Commissioner and the Tax Court determined that the taxpayer, in computing depreciation deductions, was required to use as the basis of its assets the basis in the hands of the transferors (R. 116a–138a). The Court of Appeals affirmed (R. 143–144).

ARGUMENT

The petition for certiorari involves only the application of settled principles of law to the

particular facts of the case. The appellate court's *per curiam* affirmance of the unanimous Tax Court decision was correct, involves no conflict of decisions, and raises no questions warranting further review.

1. The single issue presented was whether the taxpayer, in computing depreciation deductions, was required to use as the basis of its assets the basis in the hands of prior transferors. The lower courts recognized that the taxpayer was so required because the exchange whereby its assets were acquired was one in which neither gain or loss was to be recognized under Section 112 (b) (5) of the Revenue Act of 1936, *supra*, which provides, among other conditions, that "immediately after the exchange" the transferors must be in "control"[1] of the corporation. The determination that the transferors possessed the requisite control was patently correct for immediately after the exchange they were the outright owners of one hundred per cent of taxpayer's stock.[2]

[1] Section 112 (h) provides as follows:

(h) *Definition of Control.*—As used in this section the term "control" means the ownership of stock possessing at least 80 per centum of the total combined voting power of all classes of stock entitled to vote and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

[2] The taxpayer itself, in all its tax returns until 1941, stated the basis of the assets to be their basis in the hands of the transferors. In 1942 and 1943, when taxpayer showed a large war profit, it attempted to increase the basis. (R. 123a.)

The exchange pursuant to which the assets involved were acquired by taxpayer took place on June 3, 1936. (R. 23a.) On that date the "associates", consisting of R. S. Evans, Martin Tow and W. A. Ward, Jr., transferred to the taxpayer, together with $500 in cash, assets which they had previously purchased from the liquidating trustee of the Austin Company. Upon receipt of the assets, which were subject to liabilities in the sum of $219,099.83, the taxpayer simultaneously issued to the associates 300,000 shares of common stock. (R. 23a–24a.) Prior to the actual exchange a plan had been formulated under which three underwriters would offer to the public 90,000 shares of preferred stock to be issued by the taxpayer, and would receive as compensation, in addition to discounts and commissions, certain amounts of the common stock to be issued to the associates, this to be contingent on the sale by the underwriters to the public of various amounts of the preference stock. (R. 27a–28a, 55a–56a.) Although all of the interested parties had reached an oral understanding as to the substance of the plan prior to June 2, 1936, the date of taxpayer's organization, no written contract was consummated until June 8, 1936, or five days after the corporation issued its common stock to the associates. (R. 25a.) There was, according to the Tax Court's finding, no binding enforceable contract prior to the actual transfer and stock issue (R. 130a) with

the consequence that immediately after the transfer the associates owned and controlled 100 per cent of taxpayer's stock unfettered by any legal obligation to divest themselves of that control.[3]

Moreover, and of greater importance, the agreement between the associates and underwriters at no time contemplated or provided that the associates would be divested of control immediately after the exchange, nor did it grant to the underwriters the unqualified power to attain any portion of the transferees' stock. On the contrary it provided only that the underwriters might, subsequent to the exchange, obtain a substantial portion of the common stock from the associates only when and if they succeeded in earning that stock by sales to the public of preferred stock to be issued by the new corporation. Consequently, the ultimate acquisition of common stock by the underwriters was contingent and indeed highly speculative. On June 3, 1936, the associates were issued 300,000 shares of stock unconditionally and absolutely and no strings

[3] It is basic contract law that where a written contract is executed after elaborate negotiations have terminated in oral agreement, either of two inferences is possible: either the parties intended the written contract to stand only as a memorial of the prior binding agreement; or they considered the execution of the written contract to represent the final and necessary step in the consummation of a binding legal agreement; the Tax Court whose function it is to resolve conflicting inferences was justified in concluding that no binding contract existed until June 8, 1936. See R. 47a–52a.

were attached to the issuance of the stock to them. (R. 24a, 126a.) It was provided only that the underwriters would receive 100,000 shares of the common stock issued to and owned by the associates "when, as and if earned." (R. 27a, 51a.) The underwriters' claim to the stock was neither immediate nor unqualified. The associates were given the power to cancel the selling order if the underwriters' selling schedule were not maintained. (R. 56a.) The effect of this cancellation would be to similarly nullify the rights of the underwriters to any bonus stock to which they had not as yet become entitled. (R. 61a.) The original agreement contemplating the transfer of stock in equal proportions to the three underwriters, when and if they earned it, was never carried out. (R. 28a–29a, 60a.) During the entire year 1936 only 14,757 shares of preferred stock were sold; hence, during 1936 none of the underwriters earned the right to any common stock. (R. 25a–26a, 28a.) The associates could have canceled the entire agreement in view of the failure of the underwriters to meet their selling schedule. At the end of 1936 the associates owned and controlled stock having a voting power of 300,000 votes out of a total of 344,271 votes in existence (the 14,757 shares of preferred stock sold to the public each had three votes, thus totalling 44,271 votes). (R. 26a.) Thus at the end of 1936, or more than six months after the issuance of the taxpayer's stock in

return for the assets transferred to it by the associates, the associates still possessed "control" of the taxpayer as defined by the statute. Only Grant & Company of the original three underwriters succeeded in selling the preferred stock in any reasonable quantities, and Grant & Company "succeeded Dingwall & Co., Inc. and Tooker & Co. as 'Underwriters'." (R. 28a.) Neither of the remaining underwriters ever became entitled to or did in fact receive any stock bonus. (R. 29a.) Not until October 1937, or approximately fifteen months subsequent to the actual exchange, did the associates transfer to Grant & Company 87,900 shares of the common stock. (R. 26a.)

The lower courts correctly recognized the interrelationship of the various steps in the setting of a preconceived plan. Under the plan as originally contemplated and as actually carried out, the associates were not to be divested and were not in fact divested of control immediately after the exchange. On the contrary, they were to retain control of the corporation for at least a period of months thereafter and whether or not they would ever be divested of control was a matter of speculation. The question whether, in the light of all the facts, the associates retained control of the taxpayer immediately after the exchange was a factual issue to be determined by the Tax Court on the evidence presented. See *Commissioner* v. *Court Holding Co.*, 324 U. S. 331; *United States* v. *Cumberland Pub. Serv. Co.*,

338 U. S. 451. The Tax Court was clearly justified in concluding (R. 130a) that the exchange and the subsequent relinquishment of taxpayer's stock some fifteen months later "should not be considered part of the same transaction so as to deprive the associates of 'control' immediately after the exchange."

2. The decision involves no conflict with any other appellate court decision. In *Halliburton* v. *Commissioner,* 78 F. 2d 265 (C. A. 9), taxpayers had transferred the assets of their partnership business to a newly organized corporation pursuant to a binding agreement with various oil companies entered into prior to the transfer under which the oil companies were to subscribe to 130,000 of the 350,000 shares of capital stock. The oil companies did subscribe to the stock on the effective date of the corporation's organization. In *Hazeltine Corp.* v. *Commissioner,* 89 F. 2d 513 (C. A. 3), a contract had been consummated prior to the organization of a new corporation and the transfer to it of various assets, providing that of the 155,250 shares of stock to which the transferor would be entitled, 135,000 shares would be simultaneously delivered and assigned to another company; and in fact the 135,000 shares were never issued to the transferor but were immediately issued to the outside company. In *Heberlein Patent Corp.* v. *United States,* 105 F. 2d 965 (C. A. 2), prior to the completion of the transfer to a newly organized corporation of

assets including rights to future patents, a written contract had been consummated whereunder it was agreed that 500 shares of the 10,000 shares of stock to be issued would be issued to an outside company, and furthermore transfer powers had been executed assigning 1,525 shares of the stock to a number of individuals. In *Bassick* v. *Commissioner,* 85 F. 2d 8 (C. A. 2), certiorari denied, 299 U. S. 592, rehearing denied, 299 U. S. 623, a binding contract had been consummated prior to the transfer requiring the transferor to sell to a banking corporation 65,000 shares of the total 147,500 shares of stock issued to it by the new corporation; and further providing for the issuance by the new corporation of an additional 52,500 shares of its stock for the common stock of another company. Cf. *United States* v. *Rodgers,* 94 F. 2d 666 (C. A. 3). In each of these cases there were created prior to the exchanges enforceable rights vesting in parties other than the transferors the unqualified power to attain more that 20 per cent control of the transferee. This fact furnishes the essential distinction between them and the present case. Other cases relied upon by the taxpayer involve factual situations plainly different from that here presented.

CONCLUSION

The petition for certiorari should be denied.

Respectfully submitted.

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